NO. 3090

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HAIKU SUGAR COMPANY, PAIA PLANTATION, KALIALINUI PLANTATION COMPANY, LIMITED, PULEHU PLANTATION COMPANY, LIMITED, KULA PLANTATION COMPANY, LIMITED, MAKAWAO PLANTATION COMPANY, LIMITED, and KAILUA PLANTATION COMPANY, LIMITED, co-partners doing business under the firm name of MAUI AGRICULTURAL COMPANY,

Plaintiffs in Error,

vs.

RALPH S. JOHNSTONE, Executor under the Will and of the Estate of John F. Haley, late Collector of Internal Revenue for the District of the Territory of Hawaii,

Defendant in Error.

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BRIEF FOR PLAINTIFFS.

Upon Writ of Error to the United States District Court for the Territory of Hawaii

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CITATIONS

United States Circuit Court of Appeals for the Ninth Circuit

HAIKU SUGAR COMPANY, PAIA PLANTATION, KALIALINUI PLANTATION COMPANY, LIMITED, PULEHU PLANTATION COMPANY, LIMITED, KULA PLANTATION COMPANY, LIMITED, MAKAWAO PLANTATION COMPANY, LIMITED, and KAILUA PLANTATION COMPANY, LIMITED, co-partners doing business under the firm name of MAUI AGRICULTURAL COMPANY, *Plaintiffs in Error,* vs. RALPH S. JOHNSTONE, Executor under the Will and of the Estate of John F. Haley, late Collector of Internal Revenue for the District of the Territory of Hawaii, *Defendant in Error.*	On Writ of Error to the District Court of Hawaii

BRIEF FOR PLAINTIFFS.

STATEMENT OF THE CASE

This case comes to this court upon writ of error to review a judgment of the United States District Court for the Territory of Hawaii. The plaintiffs in error, all corporations, were the plaintiffs below. The de-

fendant in error was originally John F. Haley, Collector of Internal Revenue for Hawaii, but upon his death, before judgment, the executor of his Will, the present defendant, Ralph S. Johnstone, was substituted in his place.

The facts, being undisputed, were set forth somewhat fully in the complaint (Tr., p. 9), so that the questions of law involved might be raised by demurrer. The defendant demurred. (Tr., p. 57.) The demurrer was sustained. (Tr., p. 65.) The plaintiffs elected to stand on their complaint (Tr., p. 80), and the judgment in question was thereupon entered for the defendant. (Tr., p. 81.)

The action below was brought by the plaintiffs as co-partners doing business under the firm name of the Maui Agricultural Company (Tr., pp. 9-10), for the recovery of the sums of $2,098.83, $10,669.56 and $27,884.51, aggregating $40,652.90, paid under compulsion and protest on September 8, 1916, as income taxes for the years 1913, 1914 and 1915, respectively, under the Federal income tax law of October 3, 1913, and interest on the said sums from said September 8, 1916. (Tr., p. 25.)

The principal question is whether the Maui Agricultural Company is an organization of such a kind that it is either excepted from or not included under the income tax law of 1913, which, besides applying to persons (Par. A, Sec. II), applies (Par. G, Sec. II), subject to certain enumerated exceptions, to:

> "every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships."

The plaintiffs contend (1) that the Company in question is a partnership and therefore is expressly excluded from the operation of the law; (2) that it is not a corporation, joint-stock company or association, or insurance company, and therefore is not included within the law; and (3) that even if it could be held to belong to the genus "joint-stock company or association," it would nevertheless belong to the species of that genus which is technically held to be a partnership, though not an ordinary partnership, and as such would be excepted from the operation of the law under the general exclusion of partnerships.

Since the case was decided on demurrer, the facts are to be looked for in the complaint (Tr., pp. 9-25), the allegations of which must, of course, for the purposes of the demurrer, be taken as true.

The Company was formed under an "Indenture of Partnership," dated October 30, 1903, to take effect January 1, 1904. By-laws were adopted July 9, 1904, and slightly amended February 14, 1916. Copies of the partnership agreement (Tr., pp. 28-44) and the bylaws (Tr., pp. 45-55) are attached to and made part of the complaint. Corporations were authorized to form partnerships by an Act of the Hawaiian Legislature, which had been passed shortly before, namely, on April 28, 1903 (Tr., pp. 11-12). The partnership in question was registered as a general partnership under an Act of the Hawaiian Legislature of August 9, 1880, which provided for the registration of general partnerships. (Tr., p. 12.) These Acts will be referred to more fully below. The members of the Company in fact intended to form an ordinary general partnership, with

each member a general partner, and the liability of all the members is unlimited. (Tr., p. 11.)

The Company was formed in view and by reason of natural and special relations of the respective particular properties, chiefly lands and water rights, owned by the several members, and in view and by reason of the identity, in large part, of the shareholders of the several corporate members and close and special relations among them, and for the purpose of reducing in their mutual interests the cost of operation by co-operative management and the common use of these properties. These properties were not conveyed to the Company. The ownership of the property of each member is retained by it throughout the term of the partnership. Only its use is contributed to the partnership for the term of the partnership and that reverts to the owners upon the termination of the partnership. No other property was conveyed or money paid or subscribed for anything in the nature of stock or unit shares or otherwise. There was merely a contribution or combining of the use of their particular properties by the respective members for a specified period subject to earlier termination by the mutual consent of these particular members. The Company, indeed, has no capital stock as distinguished from its actual capital or capital assets, and the capital consists mainly of the mere use of these properties. True, it is provided in the bylaws, which, however, were not adopted until more than eight months after the execution of the partnership agreement, that the share or interest, that is, the whole interest (not unit shares), of each partner in the capital or capital assets should be evidenced by a certificate, which provision, however, has never been car-

ried out, but no stock or shares of stock or certificates of stock or certificates of shares of stock have ever been issued, or (except as to certificates of the proportionate interests of the several partners) been intended to be issued; nor has the share or interest of any member ever had any par or face value; nor has the share or interest of any member ever been or intended to be capable of being sold, negotiated or transferred so that the assignee or transferee could succeed to the right of the assignor or transferor to continue in the business of the Company, without the consent of the other members; nor is the share or interest of any member made up of unit shares so as to be divisible. The Paia Plantation has an eighteen-thirty-fifths (18/35), the Haiku Sugar Company a twelve-thirty-fifths (12/35), and each of the other members a one-thirty-fifth (1/35) interest in the partnership; and all profits and losses during the partnership and any assets that the Company may have upon its dissolution, other than the properties above referred to as retained in ownership by its members, are to be divided among them in these proportions. (Tr., pp. 12, 31, 40-41, 43.) The foregoing is a very brief preliminary summary of the facts as we understand them, showing the nature of the organization. They will be discussed more fully below.

When the special excise tax law of August 5, 1909, was passed, the Company, acting on the theory that it was a partnership, made no returns of its income, since, as recognized by the Internal Revenue Bureau, partnerships were not subject to that law; and its constituent members, likewise acting on that theory, made returns each year of their respective shares in the net profits of the partnership, whether distributed or not, which,

as also recognized by the Internal Revenue Bureau, was the proper course to pursue on the theory that the Company was a partnership.

When the law of 1913, now in question, took effect, the same course was continued both by the Company and its members. That law, indeed, expressly provided (Sec. 11, Par. D, fifth proviso):

> "That any person carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid."

And see Articles 11, 12, 13, 14 and 94 of Regulation 33 of the Internal Revenue Bureau. (Black, Income Taxes, 2nd Ed., 152-3, 183.)

From 1909 until 1916 this course was acquiesced in by the Bureau, and assessments were made by it upon the returns of the partners accordingly.

Furthermore, not only did the Bureau acquiesce in this course, but in 1914 it actually requested the Company to make a statement of its affairs as a partnership for the year 1913 for the information of the Bureau respecting the shares of the partners in the profits of the partnership, and the Company furnished the statement under the following provision of the law of 1913, contained in the same proviso, namely, the fifth proviso of Paragraph D, Section II:

> "Any such firm, when requested by the Commissioner of Internal Revenue, or any district col-

> lector, shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same, if distributed."

And see the above cited Article 12 of the Bureau Regulation 33.

In 1916, however, the Bureau, acting, as we believe, under the erroneous impression that the Maui Agricultural Company was a joint-stock company, having a capital stock divided into transferable unit shares, like the stock of a corporation, took the position that the Company was not a partnership but was a joint-stock company or association and that there should be a readjustment on that theory for the entire period, beginning with 1909.

As to the law of 1909, the Bureau still conceded that the Company itself was not subject to that law, but now based that view no longer on the ground that it was a partnership, but on the ground that it was a joint-stock company or association of the common law kind and that only those of the statutory kind were subject to that law, as held in *Eliot* v. *Freeman,* 220 U. S. 178, and *Roberts* v. *Anderson,* 226 Fed. 7. That, of course, would have been a sufficient reason why the Company would not have been subject to that law even if the Company were a joint-stock company or association. But the correct reason, as we contend, is that it was a partnership, in which case, as conceded by the Bureau, it would not be subject to that law.

And as to the members or partners, under the law of 1909, the Bureau now took the position that, assuming that the Company was a joint-stock company or association and not a partnership, the members were in error in returning their shares of the income earned

by the Company each year, whether distributed or not, and that they should have returned their shares of income actually distributed, whether that was more or less than what was earned in the particular year.

Then, as to the law of 1913, the Bureau took the position that the Company itself was subject to the tax on the theory that it was a joint-stock company or association and that the law applied to joint-stock companies or associations however formed, that is, both those of the common law and those of the statutory kind, and was not limited to those of the latter kind, as was the case under the law of 1909. And as to the partners, it took the position that, under the law of 1913, as well as under the law of 1909, they should return the income actually distributed as distinguished from that earned, whether distributed or not.

The Company, therefore, in order to avoid certain penalties and a distraint on its property and entitle it to the usual remedies of appeal and suit, was obliged to make returns of its income for the years 1913, 1914 and 1915, but, in order to save its rights, it did so under protest. It was then assessed on its income for those years in the sums of $1,399.22, $7,113.04 and $18,-589.67, respectively, at the regular rates and also 50% of each of those sums as additional taxes in the nature of a penalty for not having made its returns within the time required by law. These sums plus such 50% additions are the sums set forth on page 2 of this brief as the sums now sued for.*

*The Bureau had no discretion in the matter of the additional 50%, as the law was mandatory in regard to that, but, recognizing that the Company had acted in good faith throughout, it consented to leave in abeyance, awaiting the result of this case, the question of

All things necessary to be done to entitle the plaintiffs to bring this action have been done.

For the matters set forth in the foregoing paragraphs relating to the course pursued by the Bureau and the Company, see Tr., pp. 15-16, 17-24.

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imposition of the specific penalty of $10,000 for each of those years, as to which it had discretion, and it intimated that upon application specific penalties of only nominal amounts might be imposed, in case it should become necessary to pass upon that question, and hence no specific penalty is included in the amounts now sued for.

As to the partners, the result of a readjustment on the theory of the Bureau would be that the partners had underpaid for the years 1909 and 1913 and overpaid for the years 1910, 1911, 1912, 1914 and 1915, the total over-payments being considerably in excess of the under-payments. The amounts involved for the years subsequent to 1909 are comparatively small and the questions involved in regard to those are similar to the questions involved in the present case, and so may well be allowed to rest until the decision of the present case. The amounts involved for 1909, however, are considerable and the questions involved as to those are in large part different from the questions involved in the present case. Hence suits were brought by the United States against the seven members respectively of the Maui Agricultural Company for the determination of those questions, one of which suits, as a test of all of them, was decided by the District Court against the United States and may be brought to this court on writ of error by the United States.

SPECIFICATION OF THE ERRORS RELIED UPON

The plaintiffs rely on all six of the errors assigned (Tr., p. 89), which are in substance as follows:

In general, that the District Court erred in holding that the Maui Agricultural Company was subject to the income tax law of 1913 (5), in holding that the plaintiffs should take nothing by their action (6), in sustaining the defendant's demurrer and ordering judgment for the defendant (1), and entering judgment for the defendant (2); and

In particular, that the District Court erred in holding that the Maui Agricultural Company is a joint-stock company or association within the meaning of the income tax law of 1913 (3), and in holding that that Company is not a partnership within the meaning of that law(4)

The plaintiffs' contentions under these assignments are the three contentions stated at page 3 of this brief, which, as also already shown, may be condensed into the one contention that the Company in question is an organization of a kind not covered by the income tax law of 1913.

THE ARGUMENT

I.

THE PRECISE QUESTION AT ISSUE

(1) *The precise question at issue is whether the*

Maui Agricultural Company is a joint-stock company or a partnership or neither. Distinction between joint-stock companies and partnerships.

As shown by the quotation from Paragraph G of the law on page 2 above, the income tax law, subject to certain exceptions, expressly includes "every corporation, joint-stock company or association, and every insurance company," and expressly excludes "partnerships."

There is no pretense on the part of the Government that the Company in question is an insurance company. It is obvious also that the Company is not a corporation, although as to this, in view of certain suggestions made by the Judge and the United States Attorney, respectively, in the District Court, more will be said at pages 1~~7~~6 and 21 below.

The question, therefore, is whether the Company is a joint-stock company or association on the one hand or a partnership on the other hand within the meaning of the law.

We understand that the phrase "joint-stock company or association" is descriptive of only one class of organizations; in other words, that "joint-stock" qualifies "association" as well as "company." That seems to have been the understanding of all concerned in the District Court. The frame of the sentence, the punctuation and the purposes of the law also all go to show that that was the intention. And this appears to have been the view taken in *Eliot* v. *Freeman,* 220 U. S. 178, and *Roberts* v. *Anderson,* 226 Fed. 7, in which similar language in the excise tax law of 1909 was under construction and in which organizations of the "joint-

stock company or association" class were referred to interchangeably as "unincorporated joint-stock companies or associations," "joint-stock companies," "joint-stock associations," etc. See also *Pennsylvania Steel Co.* v. *New York City R. Co.,* 198 Fed. 774, 776. Hence, for brevity we shall in general use simply the phrase "joint-stock company." It is true that there may be an "association" which is not incorporated by statute and therefore is not a corporation, and which has not a capital stock or transferable shares and therefore is not a "joint-stock company," and which is not formed for profit and therefore is not a "partnership," as, for example, a voluntary organization, without capital stock, formed for scientific, literary, religious, charitable, patriotic or social purposes. But not only are such non-profit organizations excepted from the law under the first proviso of said Paragraph G, but the Company in question is formed for profit and therefore is not such an organization. And in ordinary legal nomenclature, as shown by the authorities cited on page 16 below, "joint-stock company" and "association" are regarded as synonymous terms when speaking of organizations for profit other than corporations on the one hand and partnerships on the other hand.

The distinction between a joint-stock company and a partnership is well established and need not be elaborated here. It is such as to make it clear that the company in question is not a joint-stock company and is a partnership.

Corporations, joint-stock companies and partnerships represent three grades of organizations and the nature of each may be best described by distinguishing it from the others as well as by naming its own characteristics

—as is often done in the text books. Without going into undue detail, suffice it to recall, for the purposes of this case, that a corporation, at the one extreme, is purely a creature of statute and when formed for profit usually has a capital stock divided into unit shares which are transferable. It has continuity irrespective of changes in its membership and is an entity distinct from its members. A partnership, at the other extreme, is organized purely by the agreement of its particular members and has no capital stock divided into transferable shares. A change in membership, as by the death or the transfer of the interest of one of its members, works a dissolution. The legal successor or the transferee cannot become a member without the consent of the other members, and, if such consent is given, it results in creating a new partnership. There is no continuity distinct from the contracting members. A joint-stock company is intermediate between a corporation and a partnership—a hybrid. Like a corporation organized for profit, it has a capital stock divided into shares which are transferable, and hence has continuity irrespective of changes in its membership. Like a partnership, on the other hand, it is created solely by agreement and is not an artificial creation of law. Joint-stock companies are of two kinds, namely, those which are organized under or privileged by statute and those which are not so organized or privileged. The former, which are usually given the privilege of suing and being sued in the name of the organization or of one of its officers, as well as other privileges, are often spoken of as the statutory kind, and more nearly resemble corporations—so much so that

they are often referred to as quasi-corporations. The latter are usually referred to as the common law kind. Since there is no organization for profit intermediate between a corporation and a partnership known to the common law, joint-stock companies are technically deemed to be partnerships. As is said in 1 Bates, Partnership, Sec. 72:

> "There is no intermediate association or form of organization between a corporation and a partnership known to the common law, and, unless otherwise provided by statute, as is the case in England and New York, a joint-stock company is treated and has the attributes of a common partnership. Yet the fact of transferable shares makes such an association different, not merely in magnitude but in kind, from ordinary partnerships."

Hence, in order to distinguish partnerships, other than those which are joint-stock companies, from such companies, they are usually called ordinary partnerships, by which is meant not partnerships of common or usual features, for ordinary partnerships differ much from each other in details, just as joint-stock companies and corporations do among themselves, but that what are ordinarily termed partnerships are not partnerships of the joint-stock kind. The word "ordinary" is used in this respect only when distinguishing what are usually spoken of merely as partnerships from joint-stock companies which, although they are partnerships technically and for certain legal purposes, are not usually called such.

The fundamental distinction between a joint-stock company and a partnership is the existence, in the

one case and not in the other, of a capital stock divided into transferable unit shares. By reason of this, a joint-stock company has, to a certain extent, a distinct entity analogous to that of a corporation, which is well brought out in *Gibbons* v. *Mahon,* 136 U. S. 549, while a partnership has no such distinct entity, as is well brought out in 1 Lindley, Partnership, *4, and 22 Am. & Eng. Enc. of Law, 2nd Ed., 75. Of course, even an ordinary partnership may be and often is treated, as a matter of form or convenience, as a distinct entity by business-men or in equity or under special statutory provisions, but in general and legally a partnership does not exist apart from its members. It is simply the members themselves doing business together instead of separately under a contract between themselves and themselves alone. There is a *delectus personarum,* or choice of members. A joint-stock company is the result of an attempt to make a partnership as nearly like a corporation as that can be done by mutual agreement, as distinguished from statute, in respect of membership and continuity.

Other features may more commonly exist in the case of joint-stock companies than in the case of partnerships, but they are not fundamental. Usually joint-stock companies are of much larger membership, but that is immaterial, the essential feature being the fluctuability of membership. Ordinarily, also, they are governed by boards or committees or managers, which naturally is highly convenient because of the number and changeability of the members, but that is immaterial, for ordinary partnerships also may be, and not infrequently are, governed the same way. They more often have a common name.

On the distinction between partnerships and joint-stock companies and questions incidental thereto, see:

1 Fletcher, Cyclopedia Corporations (1917), Secs. 16, 17.
17 Am. & Eng. Enc. of Law, 2nd Ed., 636-8 and notes.
5 Earl of Halsbury, Laws of England, Secs. 1-2.
Lindley, Partnership, Vol. I, *4-6; Vol. II, *610-613, 661-2, 675; Sec. II, 678-9, 1083 *et seq.*
1 Bates, Partnership, Secs. 72, 75, 76.
2 Bouvier, Law Dict., 3rd Ed., 1704.
Smith v. *Anderson,* L. R. 15 Ch. Div., 247, 273.
Industrial Lumber Co. v. *Texas Pine Land Ass'n,* 72 S. W. (Tex.), 875, 878.
Roberts v. *Anderson,* 226 Fed. 7.
Flint v. *Stone Tracy Co.,* 220 U. S. 107, 144.

Apparently it is because joint-stock companies are so nearly like corporations in the feature of being entities distinct from their members that they are included with corporations for the purposes of the income tax law; and likewise, because of the nature of partnerships as not being entities distinct from their members, that their members, and not the partnerships themselves, are subjected to the tax like other individuals.

(2) *The Company in question is not a corporation.*

Although we have stated above that it is obvious that this Company is not a corporation, and although it was not contended by the Government in the District Court that it is a corporation, still the District

Judge in his decision made several suggestions to the effect that it might be considered a corporation, although apparently he did not intend to decide that it was a corporation. We shall, therefore, dispose of these suggestions before proceeding with the argument upon the question whether the Company is a joint-stock company or a partnership.

First, the Judge, quoting from Blackstone, suggests (Tr., p. 77) that, since persons are either natural or artificial, and since those that are artificial are corporations, and since the Company in question is not a natural person, it must be an artificial person and therefore a corporation, whether it is a joint-stock company or a partnership or not.

But, if the Company is a partnership, it of course cannot be a corporation. Likewise, if it is a joint-stock company of the kind in question, it cannot be a corporation, although there are organizations which are known as incorporated joint-stock companies, which are really corporations. See the next subdivision (3) of this brief. (The joint-stock companies provided for by Hawaiian statutes are full-fledged corporations. Rev. Laws, 1915, Sec. 3272 *et seq.*) Moreover, this Company cannot be a corporation in any event, because it was formed solely by agreement of its members and has not been made a corporation by or under any statute.

The fallacy of the Judge's syllogism, however, lies in the assumption that the Company, assuming it to be a partnership, is a person at all, whether natural or artificial. If it is a partnership, it is not a person at all, whether natural or artificial, but a group of persons indistinguishable from the persons composing it.

Secondly, the Judge, after enumerating what he considers certain features of this Company, with which we do not wholly agree, and referring to the Hawaiian law which permits corporations to form partnerships, suggests (Tr., p. 78), in view of these features and this law, that the Company may be regarded as a corporation, holding that "it is not necessary that it be created as a corporation to make it one in fact, or be called one or that it be chartered as such or even have a charter," and citing 1 Clark & Marshall, Private Corporations, 48; *Liverpool Ins. Co.* v. *Massachusetts,* 10 Wall. 566, and *Oliver* v. *Liverpool Ins. Co.*, 100 Mass. 531.

But, as already stated, the Company in question is a creature solely of an agreement of its members. It does not even possess any of the special privileges often conferred by statutes elsewhere upon joint-stock companies and which, even though they may make such companies analogous in some respects to corporations, are usually held not to make them corporations. In the cases cited by the Judge, the company was an English company and had been given by statute extensive privileges which, among other things, made it an entity so distinct from its members that it and its members could sue and be sued by each other, and in fact really made it a corporation, and it was held, in view of these features that, although it might not be considered a corporation in England where it was created, it could be considered such within the meaning of a particular tax law of Massachusetts. The entire section in Clark & Marshall, to one page of which reference was

made by the Judge, throws further light in this direction.

Moreover, although corporations of certain kinds, such as ecclesiastical corporations sole, not including, however, corporations for profit, have existed at common law in England and in some of the original states of the United States, on the fiction that a charter had been granted but had been lost in the exigencies of time, yet as a rule not even such can exist in this country apart from statute and certainly not in Hawaii. 1 Clark & Marshall, Private Corporations, Sec. 37; *Bishop of Zeugma* v. *Paahao,* 16 Haw. 345. Much less could corporations aggregate for purposes of profit exist in this country and especially in Hawaii apart from statute.

The Hawaiian statute permitting corporations to form partnerships did not make the partnerships when formed, corporations. It had to do merely with the powers of the several members and not with the organization resulting from the exercise of those powers, just as a statute permitting infants or married women to form partnerships, that is, removing previously existing disabilities in this respect, would not make the resulting partnerships, corporations. The mere fact that there was, if there was, a statute of some kind that affected the concern would not make it a corporation. Much less would the mere fact that there is a statute that affects the several members make the concern itself a corporation.

Thirdly, the Judge suggests (Tr., p. 78) that even if corporations may form partnerships or joint-stock companies, they cannot thereby take themselves or their business out of the operation of the law; the

idea being, apparently, that they cannot by such action be permitted to evade the law.

But the law must be applied as it is; if the Company does not come within it, it is not subject to it. *Phillips* v. *Blatchford,* 137 Mass. 510, 512-3. For instance, corporations which merely held investments, including investments as stockholders in or members of other corporations, and did not carry on business themselves, were held not to be within the excise tax law of 1909. *McCoach* v. *Minehill R. Co.,* 228 U. S. 295; *United States* v. *Nipissing M. Co.,* 206 Fed. 431; *Jasper & E. R. Co.* v. *Walker,* 238 Fed. 533; *Butterick Co.* v. *United States,* 240 Fed. 539.

Moreover, the corporate members of this Company are not taking themselves or their business out of the operation of the law. As partners, they are liable to be taxed on the entire income of the business, and they have always made returns of the entire income, whether all of it was actually distributed to them or not. It is simply a question whether they should be subjected to double taxation by being taxed additionally in the aggregate as well as separately.

Of course, also, this Company was not formed with any intention of evading the income tax law, for it was formed in 1903, or many years before that law, and indeed many years even before the excise tax law of 1909, was enacted or contemplated; and if the partnership in question had not been formed, the several corporate members would not be subject to any greater taxes than they are now subject to individually as partners, and probably not as great, for their net income would probably not be as great.

The partnership was formed for the very purpose of increasing the aggregate net income through co-operation and the common use of the several properties, which were so related to each other that they could be utilized more profitably together than separately.

Again, the suggestion goes too far, since it would apply to ordinary persons as well as to corporations, for both ordinary persons and corporations are subject to income taxes under the law in question, and there is no more reason why a partnership, as distinguished from its members, should be taxed in addition to its members, when the members are corporations than when the members are persons.

The suggestion goes too far also in that it holds, contrary to established law, that corporations, when authorized, as is the case under the laws of Hawaii, to form partnerships, cannot do so without the partnerships so formed being held to be corporations or joint-stock companies, which would nullify, or rather make different, the law.

(3) *The Company in question is not a limited or special partnership.*

It was suggested on behalf of the Government in the District Court that this Company might be considered a limited partnership and that therefore it might be held to be subject to the income tax law as a corporation under Article 86 of Regulation 33 of the Internal Revenue Bureau (Black, Income Taxes, 2nd Ed., 180), which reads as follows:

> "Limited partnerships are held to be corporations within the meaning of this act and these

regulations, and in their organized capacity are subject to the income tax as corporations."

There are two kinds of so-called limited partnerships. One kind is really an ordinary partnership between particular individuals but with the statutory modification that some of the partners, upon complying with certain conditions, shall not be liable for the debts of the partnership beyond the amount of capital contributed by them, creditors being obliged to look only to the partnership property and the general liability of the other partners. The special partners are usually also silent partners. The other kind is substantially a corporation having transferable shares and limited liability as to all of the members. 30 Cyc. 752-3. The latter kind may well be considered to be corporations, at least for some purposes. 28 *Op's. Att'y Gen'l,* 189. Perhaps they may be so considered for the purposes of the income tax law. No case has so decided. It would seem, however, that limited partnerships of the other kind could not be so considered. See *Chapman* v. *Barney,* 129 U. S. 677, 681-2; *Great So. F. P. H. Co.* v. *Jones,* 177 U. S. 449, 454.

The Hawaiian laws (Revised Laws, 1915, Secs. 3387-3409), provide for limited partnerships of the first kind but under the name of special partnerships. They do not provide for limited partnerships of the second kind. It was suggested on behalf of the Government in the District Court that the Company in question is such a special partnership. The suggestion was based on the proposition that the Hawaiian Act, above referred to, which permits cor-

porations to form partnerships, permits them to form only special and not general partnerships.

But even if the Hawaiian laws permitted corporations to form only special partnerships, and even if this Company had been formed as a special partnership under those laws, it would not be a limited partnership of the kind that could be considered a corporation.

These laws, however, we submit, clearly permit corporations to form either special or general partnerships. The Act which permits corporations to form partnerships, which is Act 51 of the Session Laws of Hawaii of 1903, entitled "An Act Concerning Corporations," provides in Section 1 that:

> "Any two or more corporations organized and existing under and in conformity with the laws of the Territory of Hawaii, may enter into partnership with each other, in conformity with Chapter 70 of the Session Laws of 1886."

And Chapter 70 of the Session Laws of 1886 provides in Section 1 that:

> "A partnership may be formed between two or more persons for the transaction of any lawful business. A special partnership may be formed between one or more persons, called general partners, and one or more persons called special partners, for the transaction of any business."

Thus these laws provide for the formation of both general and special partnerships. In view of what

is stated in the succeeding paragraphs, we need not enlarge upon this point here. In our brief in the District Court we set forth in full, for the reasoning it contained, a legal opinion rendered to this Company at the time of its formation, holding that the Act in question permitted corporations to form either general or special partnerships, but we deem it unnecessary to encumber this brief in that way. We will only add here that in *Dong You* v. *Wing Hing Co.,* 22 Haw. 660, 662-3, the Supreme Court of Hawaii took it as a matter of course that the statute permitted corporations to form general partnerships with other corporations, but held that it did not permit corporations to form either kind of partnership with natural persons.

This Company, however, was in fact formed as a general partnership, whether the Act in question permitted it to do so or not. This is shown by the allegations of the complaint and the provisions of the partnership agreement and the by-laws. There is no limited liability; there are no special partners. The provisions of the law specifying the requisites for the formation of special partnerships were not complied with. On the contrary, as already shown, the Company complied with the law relating to general partnerships, namely, Act 28 of the Session Laws of 1880, and it registered as a general partnership under that law.

The Acts of 1886 and 1903, just referred to, are now embodied in Chapter 188, and the Act of 1880 in Chapter 189, of the Revised Laws of 1915.

Now, if the law permitted corporations to form only special partnerships, and if these corporations

did not comply with that law, they became general partners or a general partnership under the very provisions of that law, for that law expressly provides in Section 3393 (referring now to the Revised Laws of 1915), that "no special partnership is formed until the provisions of the preceding three sections are complied with," and in Section 3394 that in case the publication required to be made of the certificate is not made, "the partnership must be deemed general." Sections 3391, 3402, 3404, 3405 and 3406 state other situations in which the partnership will be deemed to be general.

Again, if, as is clear, a special partnership was not formed, and if a general partnership was not formed on the theory that that would be *ultra vires,* then nothing was formed, and there would be nothing to be taxed, and, although the Company might perhaps be estopped from setting up the defense of *ultra vires* as against persons who have dealt with and been misled by a "holding out" by the Company, yet, we submit, it would not be estopped from setting up that defense as against the Government, which has not dealt with or been misled by it, but has sought to impose certain impositions upon it from without.

But, assuming that the defense of *ultra vires* could not be set up and that it is immaterial for the purposes of the tax law whether an organization of any kind has been legally formed or not, and that the question is merely what the organization is in fact, aside from the question of its legality, even if these corporations could not form a general partnership, as matter of law, that would not make them a special

partnership and still less would it make them a corporation or a joint-stock company. They formed a general partnership or nothing in fact. The most that could be contended would be that they formed a general partnership in fact, whether they could in law or not, in which case the Company would be excepted, as a partnership, from the operation of the tax law in question.

II.

THE MAUI AGRICULTURAL COMPANY IS AN ORDINARY PARTNERSHIP.

Bearing in mind that by an ordinary partnership is meant simply a partnership as distinguished from a joint-stock company or association, it is clear that the Company in question is such a partnership from every point of view, and whether positive or negative tests are applied.

Whether the Company is a partnership or not is a question of intention, to be ascertained by the declarations of the parties, their acts and conduct, and the legal effect of the agreement under which the Company was formed. A partnership agreement is subject to the same rules of construction as other agreements. The legal effect of the instrument, of course, controls irrespective of what the parties may call it or what they may think its effect is, if that effect is clearly different from what they call it and what they think it is. But, unless this is clearly different from what the parties declare it to be and show by

their acts and conduct they understand it to be, their declarations and acts and conduct control. In the present case, the declarations, acts and conduct, and the legal effect of the provisions of the agreement, all harmonize and combine to make the strongest possible case for a partnership.

The following general rules are stated in 1 Bates, Partnership, Sec. 17:

> "To determine whether the relation between persons constitutes a partnership their intention in forming it governs. * * *
>
> "The declarations of the parties themselves upon the subject, if not inconsistent with the other terms of the contract, will control. * * *
>
> "The intention of the parties will be determined from the effect of the whole contract, regardless of special expressions. * * *"

First, as to the declarations of the parties, both in and out of the agreement itself. The parties begin the agreement by describing it as "This Indenture of Partnership" (Tr., p. 28). The provisions of the agreement are arranged according to subject-matter with titles for the several subdivisions, some of which titles read as follows: "Objects of Co-partnership" (Tr., p. 29), "Term of Partnership" (Tr., p. 31), "Partnership Assumption of Debts and Liabilities" (Tr., p. 37), and "Dissolution of Partnership" (Tr., p. 42). The language of the text is equally expressive of an intention to form a partnership. For instance, the recitals state (Tr., p. 29) that the parties "have mutually agreed each with the other to enter into partnership," and the body of the agreement

states (Tr., p. 29), that "the said parties hereto will, and hereby do associate themselves together as partners." The by-laws, adopted eight months later, refer, as in Articles II, IV and IX (Tr., pp. 44, 49), to the agreement as the "Articles of Partnership." Throughout the agreement and by-laws such expressions are found as "partnership," "this partnership," "said partnership," the "partners," "said partners," "each partner," etc. The printed copy of the partnership agreement and by-laws, published some years later but several years before the present controversy arose, and attached to and made part of the complaint, is entitled on the cover and on the title page, "Partnership Agreement and By-Laws of the Maui Agricultural Company" (Tr., p.27), and the agreement therein is entitled "Partnership Agreement Between the Seven Companies Forming the Maui Agricultural Company" (Tr., p. 28), and the by-laws therein are entitled "By-Laws of the Maui Agricultural Company (a Partnership)." (Tr., p. 45.)

The words erased in the transcript are on the printed copy of the agreement and by-laws but not on the original typewritten copies.

Secondly, as to acts and conduct. The understanding that a partnership had been formed is shown by subsequent acts and conduct, as, for instance, when under the tax laws of 1909 and 1913 the several partners returned, for purposes of taxation, their distributable (larger) shares of the income of the Company as distinguished from the (smaller) amounts actually distributed to them. But, what is of greater significance, their intention to form a partnership is shown by their acts and conduct at the inception of the Com-

pany and in accordance with its formation. For instance, they formed the Company and intended to form it under authority of the Act above referred to, which was passed shortly before and which provided that "any two or more corporations organized and existing under and in conformity with the laws of the Territory of Hawaii, may enter into partnership with each other." And having formed, as they believed, an ordinary general partnership and intending it to have that legal status, they registered it as such under the provisions of the Act, also above referred to, which provided for the registration of co-partnership firms.

Thirdly, as to the legal effect of the partnership agreement. The books usually discuss many features that have been advanced from time to time as tests of partnership or guides to determining the intention of the parties in this respect. Mr. Bates, in Section 24 of his work on Partnership, says:

> "The intention of the parties being the sole criterion of partnership, certain principles may be laid down as approximate guides to ascertain it."

He then proceeds to discuss at length certain classes of tests or guides, such as (1) provisions for sharing both profits and losses, (2) provisions for sharing profits with nothing said as to losses, (3) provisions for sharing profits with express provisions against sharing losses, and (4) provisions for sharing gross receipts. He shows that provisions of any of the first three of these classes result in a partnership, and of course that is pre-eminently so of provisions of the

first class, namely, those for sharing both profits and losses, which is the case here. This is the test of the highest grade possible. That a sharing of profits as owners is the true and only test is shown by the very definition of a partnership. See the definitions collected in 1 Lindley, Partnership, *2, and 22 Am. & Eng. Encyc. of Law, 2nd Ed., 13, and notes. It is, however, the character rather than the fact of profit-sharing that controls. 22 Am. & Eng. Encyc. of Law, 2nd Ed., 22, 27. The sharing of the profits must be by the persons as owners or principals and not in some other capacity as, by way of salaries or wages of officers or employes, or interest on loans, or rent under leases, but if there is a sharing as owners the company is a partnership, whether the contributions of the partners are of property or the use of property or services, or whether they are equal or unequal in amount, or whether the profits and losses are to be shared equally or unequally, or whether all the partners are to participate in the management or that is to be left to one or more of them or even to outsiders, and whether they have a common name or not.

The leading American case on this subject is *Meehan* v. *Valentine,* 145 U. S. 611, in which the court, by Mr. Justice Gray, after stating the rule at the outset and then reviewing numerous authorities on the subject, concluded, on page 623, as follows:

> "In the present state of the law upon this subject, it may perhaps be doubted whether any more precise general rule can be laid down than, as indicated at the beginning of this opinion, that those persons are partners, who contribute either

property or services to carry on a joint business for their common benefit, and who own and share the profits thereof in certain proportions."

We cite this case as one of a series of cases which support and illuminate this proposition, the later cases referring to the earlier ones. The others are:

Ward v. *Thompson,* 22 How. 330.
Fleming v. *Lay,* 109 Fed. 952.
Fechteler v. *Palm Bros. & Co.,* 133 Fed. 462.

The foregoing principles are established law in Hawaii. In *Barnes* v. *Collins,* 16 Haw. 340, the Court, citing *Meehan* v. *Valentine, supra,* and also earlier Hawaiian cases, and finding that there was a partnership, said on pages 342-3:

"What constitutes a partnership is a matter of some diversity of opinion, but in general it may be said that, according to what is called modern doctrine, a partnership exists where the parties have contracted to share, as common owners or principals, the profits of a business and that whether an agreement creates a partnership or not depends upon the intention of the parties. * * * If the right to share in the profits is merely by way of compensation in lieu of salary or wages performed or of interest for money loaned or of rent for land or of compensation for acting as agent and not by virtue of ownership of the profits, there is not a partnership. The natural inference is, in the absence of a contrary showing, that if one has a right to share in the profits it is because he is a co-owner of the profits. If in addition to a right to share in the profits there is also a liability for losses or expenses the

case is greatly strengthened, for agents or servants or loaners of capital are not usually liable for losses or expenses. Of course there need be no partnership name, nor need it be stipulated that there shall be a partnership, nor is it necessary that the partners should understand or realize what the legal consequences of their agreement will be. The question is whether that which they have agreed upon constitutes a partnership as matter of law; that is, did they agree to become co-owners of the profits."

In *Winkelbach* v. *Honolulu Amusement Co.,* 20 Haw. 498, the Court, finding that there was not a partnership, said on pages 502-3:

"The agreement is wholly destitute of the usual and ordinary words and expressions, such as 'partnership,' 'partners,' 'profits,' etc., commonly employed in partnership agreements; and the language used fails to disclose, or even to intimate, any community of interest, or co-ownership, or sharing of profits, tending to show the relation of partners."

The agreement in question, after stating (Tr., p. 31), the respective proportionate interests of the several partners, provides (Tr., pp. 40-41) for the sharing of both profits and losses in the same proportions and (Tr., p. 43) for the division in the same proportions of all surplus funds of the Company upon its dissolution—the property the use of which is contributed by the several partners at the outset, remaining their property respectively throughout the term of the partnership (Tr., p. 36) and upon its dissolution (Tr., p. 43). The profits under these provisions

are, of course, shared by the members as owners or principals and not in any other capacity, such as persons who have entered into contractual relations with the Company, whether as employes or creditors or lessors.

Thus, it is as clear as anything can be, from the declarations and acts and conduct of the parties, that they intended to form and believed they did form an ordinary partnership. This actual and expressed intention could be overcome or nullified only by a clear showing that the parties unwittingly used such other language or inserted such other provisions as to produce a legal effect which they did not intend or that they mistook the nature of the arrangement which they intended to make. But so far from there being anything to sustain such a conclusion, the agreement is replete with evidence that its legal effect is precisely what the parties intended. This, indeed, is a most typical case of an ordinary partnership. The evidence is all one way.

It is true that there is, in a sense, a sharing of profits as owners, although this may not be worked out in precisely the same way, in the case of a joint-stock company as well as in the case of an ordinary partnership, and that joint-stock companies, especially those of the common law kind, are technically considered in law as partnerships. But, while a sharing of profits in the case of a voluntary organization for profit is sufficient to make a partnership, it is not sufficient to make a joint-stock company. To make the latter, there is required the additional element of changeability of membership. All definitions of partnership turn on the point of common ownership of profits,

while all definitions of joint-stock companies turn on the transferability of shares. When partnerships are spoken of, ordinary partnerships are usually meant, and when partnerships of the joint-stock company kind are meant they are usually spoken of as joint-stock companies. In the agreement and by-laws in question there cannot be a particle of doubt that a joint-stock company was not meant by "partnership." In these documents also there is nothing whatever, either expressly or by implication, to indicate an intention that the interests of the members should be transferable; much less that there were intended to be transferable unit shares. That would be sufficient to preclude the idea of a joint-stock company, for without such an indication the interests would not be transferable or the membership changeable. These documents, however, go further. They are not merely silent or neutral in this respect. They are full of evidences negativing the idea of transferability and showing that the contract of partnership was intended to be solely between the particular parties thereto and no others. This will be shown more appropriately under another heading below.

Counsel for the Government in the District Court urged "agency" as a test of partnership. Even if that were a test and if it showed that the Company in question is not a partnership, it would nevertheless not have the result of making the Company a joint-stock company. We propose, however, to show below that there is nothing whatever in the present case in respect of agency that would prevent this Company from being an ordinary partnership. But, further, agency is not a test of partnership. It was

at one time put forth as such a test, but it has now been discarded, not indeed because mutual agency does not exist in a partnership, but because it results from partnership rather than partnership from it. To adopt that as a test would be to assume the thing to be proved.

> *Meehan* v. *Valentine,* 145 U. S. 611, 622.
> 22 Am. & Eng. Encyc. of Law, 2nd Ed., 23.
> 1 Bates, Partnership, Sec. 18.

Counsel for the Government in the District Court relied also largely on the doctrine of *delectus personae.* That is what we rely on and is merely another way of expressing the difference between a partnership and a joint-stock company in respect of changeability or non-changeability of membership. We propose to show below that this is a peculiarly strong case for the application of the doctrine of *delectus personae* because of the positive provisions of the partnership agreement and by-laws inconsistent with the idea of transferability as well as because of the absence of provisions for transferability.

III.

THERE IS NOTHING WHATEVER IN THE PRESENT CASE THAT MILITATES AGAINST THE MAUI AGRICULTURAL COMPANY BEING AN ORDINARY PARTNERSHIP.

We have shown affirmatively from the provisions

of the partnership agreement and the declarations and acts of the parties, that this Company is a typical ordinary partnership. We propose now to show negatively that there is absolutely nothing to overcome or rebut this. The arguments offered by the Government in the District Court for the purpose of negativing this seemed to center about the three subjects of corporate membership, board management and capital stock. Presuming that similar arguments will be advanced in this court, we will take these up in their order.

1. *The Fact that the Members of the Company are Corporations does not Militate against the Company being an Ordinary Partnership.*

We cannot but feel that the fact that the members of the Company are corporations helped to becloud the situation to the Bureau, or had some effect in throwing the Bureau or its agent off the right track. For, if the members were natural persons, it would seem almost impossible that any one would question the character of the Company as an ordinary partnership. And yet, although it is not very common for corporations to form partnerships, it is obvious that the fact that the members of what would otherwise be an ordinary partnership are corporations, cannot make the slightest difference. The question is not what the members are, but what the Company is.

Either these corporations could legally form an ordinary partnership or they could not. If they could, no argument that they did not in fact form such a partnership can be based on the fact that they are corporations. If they could not, then either noth-

ing was formed, or, if they could not deny that something was formed, it would be only an ordinary partnership *de facto.* The fact, if fact it were, that they could not legally form an ordinary partnership, would not make the organization which they attempted to form as an ordinary partnership something else, such as a corporation or a joint-stock company. Indeed, the same reasons, if any, which would prevent these corporations from forming an ordinary partnership, would likewise prevent them from forming a joint-stock company. See *Merchant's National Bank* v. *Wehrmann*, 202 U. S. 295, 300-1, in which it was held that a national bank could not become a member of a partnership which in that case was of the common law-joint-stock company kind.

The doctrine of mutual agency in partnerships is unaffected by the fact that the members are corporations. A corporation as well as an individual may act as or through an agent. If the fact that the members are corporations would be inconsistent with the idea of agency, and if that in turn would be inconsistent with the idea of a partnership, then it would follow that corporations cannot form partnerships at all, which is contrary to all the authorities and to the statute of Hawaii above referred to.

Similarly as to the doctrine of *delectus personae.* Particular corporations may enter into an agreement between themselves and themselves alone as well as individuals can. This, as we have seen, is all that this doctrine means. The fact that the membership of each corporate partner may change from time to time through transfers of shares is immaterial. It is the corporations as distinct entities and not their stock-

holders that are the partners. If the fact that the members of each corporate partner may change, would negative the idea of *delectus personae* so as to prevent corporations from forming an ordinary partnership, that would be the equivalent of saying that corporations cannot form ordinary partnerships at all, which, as already stated, is contrary to all the authorities and the statute.

Any argument based on the fact that the members are corporations goes too far. It either leads to a conclusion contrary to established law (that corporations may form partnerships so far as the law or nature of partnerships is concerned), or else to the destruction of the Government's case by showing also that corporations cannot form joint-stock companies.

It is true that ordinarily corporations cannot form partnerships without statutory authority, but that is not because of the nature of a partnership, but because of lack of power on the part of the corporation. If such power is given, or, to put it another way, if the disability is removed, then a corporation may enter into partnership just as a married woman may enter into partnership when her disability to contract is removed. As Bates (1 Partnership, Sec. 1) says:

> "While a corporation does not generally have capacity, as we shall see, to become a partner, the reason is not in the nature of the partnership, but in want of power in the corporation, and power being granted in the charter, it may enter a partnership with an individual or another corporation."

See also *Id.*, Secs. 133, 134.
1 Lindley, Partnership, *86.

The reason why corporations may not ordinarily enter into partnership with other corporations or persons is that that is not among the usually implied powers of a corporation, and particularly because a corporation is supposed to be controlled by its stockholders through its directors and officers, while, if it should become a partner, it would, owing to the mutual agency that generally exists among partners, be subject, to some extent at least, to the control of the other partners. See Bates and Lindley, *ubi supra,* and

> *Fechteler* v. *Palm Bros. & Co.,* 133 Fed. 462, 465.
> *Mallory* v. *Hanaur Oil Works,* 86 Tenn. 598, 604-5.
> *Dong You* v. *Wing Hing Co.,* 22 Haw. 660, 663.

There is, however, nothing inherently unlawful or insuperable in a corporation becoming a partner, and hence the rule that it cannot ordinarily do so yields readily to express or implied provisions in the statute or charter and even to circumstances; for where the reason fails, the rule itself does not apply.

As was said in *News-Register Co.* v. *Rockingham Pub. Co.,* 86 S. E. (Va.) 874, at 876:

> "The law to this effect (that corporations cannot form partnerships) is old and well settled, but not more so than the converse proposition that, when the authority is given, the exercise of such power is entirely competent and valid. This is so because when the power is given in the charter, the reason underlying the rule against its exer-

> cise no longer exists. * * * There never has been and is not now any essential illegality in the power of a corporation to form a partnership."

And, as was said in *Morgan* v. *Child, Cole & Co.*, 47 Utah, 417, at 427:

> "The question of whether a corporation may or may not become a partner depends upon circumstances, and whether it, by its charter or statute, is given capacity to do so."

A corporation may be authorized to become a partner expressly by statute, as under the Hawaiian statute above referred to; or expressly by charter, as in *News-Register Co.* v. *Rockingham Pub. Co., supra;* or impliedly by statute, as in *Butler* v. *American Toy Co.,* 46 Conn. 136, where a statute incorporating a firm which had been in partnership with another firm, was held to authorize the corporation to continue the partnership; or impliedly by charter, as in *Burke* v. *Railroad,* 61 N. H. 160, 243-249, where the charter authorized the company to do what was reasonably necessary for accomplishing the objects of its corporate existence (which, however, as the court said, would be the case even if it were not so provided in the charter), and where the court held that whether the corporation could enter into partnership with another railroad company depended upon the question of fact whether that was reasonably necessary, but found in that particular instance that it was not reasonably necessary, since the object could be accomplished just as well in another way. The power

may exist also in the absence of either express or implied statutory or charter authority where the circumstances are such that the reasons for the rule do not apply, as in *Allen* v. *Woonsocket Co.,* 11 R. I. 288, where that was held on account of special facts, including the fact that there was only one stockholder; or as in *Bates* v. *Coronado Beach Co.,* 109 Cal. 160, 162-163, where the corporation was to be the sole manager; or as in *Kelley* v. *Biddle,* 180 Mass. 147, 149, where there was to be a general manager. Some courts have gone even so far as to hold that in the absence of special authority a corporation may enter into a partnership for carrying on a business of the same kind as that for which it was created, as in *Catskill Bank* v. *Gray,* 14 Barb. 471, 479. In still other cases partnerships between corporations, as in *Lamoille Valley Ry. Co.* v. *Bixby,* 55 Vt. 235, or between a corporation and an individual, as in *Trustees of Catskill Bank* v. *Hooker,* 5 Gray, 574, have been recognized without any question being raised as to their validity.

The important thing in this connection is that whether the organization of which a corporation undertakes to be a member is a partnership or not, depends entirely upon partnership law, and is to be determined precisely as it would be determined if all the parties were natural persons. Then, if the organization is found to be a partnership, the further question may arise as to whether the corporation could legally enter into it, and, if not, what is the result under the particular circumstances of the case and with reference to the nature of the questions involved and the way in which they are raised.

As is said in 2 Fletcher, Cyclopedia Corporations, 1804:

> "Whether an agreement actually constitutes a partnership is to be determined by the general rules relating to partnerships, which are the same when a corporation is a partner as when all the partners are individuals."

This is well illustrated in the following cases to which we call special attention:

In *Mallory* v. *Hanaur Oil Works,* 86 Tenn. 598, the decision of the Supreme Court of Tennessee was written by Judge Lurton, later of the Supreme Court of the United States. Four corporations entered into an agreement for the formation of what they called a "combination syndicate" and "partnership," by the terms of which they were to select a committee composed of representatives of the several corporations and turn over to the committee the use but not the ownership of the properties of the corporations to be managed and operated by the committee through officers, agents and employes selected by it, the profits and losses to be shared in certain apparently unequal proportions agreed upon, and this arrangement was to continue for a definite term, and might, by consent, continue for a certain additional period. Afterwards another corporation was admitted, under a provision in the original agreement, making five in all. There could hardly be a case more closely like the present case—corporate members, specified unequal interests, contributions of the *use* of property, management by a board of representatives of the several corporate members, sharing of the profits and losses in

certain unequal proportions, continuation for a definite term. The court said, on page 602:

> "A careful examination of this agreement discloses every material element to a contract of partnership. The absolute ownership of the corporate property, the mills, machinery, etc., is not conveyed to the partnership, nor is this necessary. The beneficial *use* of all such property is surrendered to the common purpose. The provisions for the complete possession, control, and use of the properties of the several corporations by the partnership or syndicate is perfect. Nothing is left to the several corporations but the right to receive a share of the profits and participate in the management and control of the consolidated interests as one of the new association. The contract is, both technically and in its essential character, a partnership in so far as it is possible for corporations to form such an association."

The court, however, held that the formation of partnerships was not among the implied powers of corporations and that the laws of that state did not confer such powers, and hence that the defendant, one of the corporate members, could treat the agreement as void and withdraw from the arrangement and retake possession of its property.

It is clear that if in that state the formation of partnerships by corporations had been permitted by statute, as is the case in Hawaii, the court would have held that the agreement was valid and that a partnership was created. As it was, it held that nothing was legally created, and that the corporate member in question was not estopped from so claiming.

In *Burke* v. *Railroad,* 61 N. H. 160, already cited,

an organization was formed by two railroad corporations, which contributed the use of their property and were to divide the profits in the proportions of sixty and forty per cent. The organization was to have a general manager and a cashier. This was held to be a partnership, although nothing was said about "partnership" in the agreement, but the court also held that because it was a partnership and because of the absence of sufficient authority to form it, an injunction should issue against continuing it.

In *News-Register Co.* v .*Rockingham Pub. Co.,* 86 S. E. (Va.) 874, also already cited, two publishing corporations formed an organization for a definite period of ten years, each contributing the use of its property and some cash. Profits were to be shared equally. This was held to be a partnership. It was also held to have been legally formed because the corporations were authorized to enter into partnerships by their charters.

See also the above cited cases of

Morgan v. *Child, Cole & Co.,* 47 Utah, 417.
Fechteler v. *Palm Bros. & Co.,* 133 Fed. 462, and
Dong You v. *Wing Hing Co.,* 22 Haw. 660, for

other instances in which organizations were held to be or not to be partnerships according to partnership laws and irrespective of whether the members were corporations or not, the latter question being deemed of importance only for the purpose of determining the rights and remedies of the parties under the respective circumstances after ascertaining whether the organizations were partnerships or not.

2. The fact that the Company is managed by a board of managers does not militate against its being an ordinary partnership.

In the District Court it was argued for the Government and held by the court (Tr., p. 77) that the provisions in the partnership agreement for the management of the Company by a board of managers negatived the idea of mutual agency among the members and therefore negatived the idea of partnership. This, we submit, has no such effect.

The argument seems to be based partly on the idea that management by a board is a characteristic of a joint-stock company and hence that such management in this case shows that the Company in question is a joint-stock company, and partly on the idea that agency is a characteristic of an ordinary partnership and hence that its contended absence in this case shows that the Company in questions is not a partnership. Neither of these views can be sustained on either principle or authority.

Although management by a board is usual, it is not essential in the case of a joint-stock company; and although it is not usual, it may exist in the case of an ordinary partnership. The number and changeability of the members of a joint-stock company usually call for such management as a practical matter in the case of a joint-stock company, while the opposite features in the case of an ordinary partnership usually do not call for that as a practical matter.

It is true that this feature of a joint-stock company is often, though by no means always, referred to in describing joint-stock companies, but, so far as we are

aware, it is never referred to as one of the essential or determining features of a joint-stock company as distinguished from an ordinary partnership. A joint-stock company is always defined with reference to the feature of transferability of shares. Often, it is true, but by no means always, an added statement, not a part of the definition, is made, to the effect that usually, if not always, such a company is managed by a board. Usually other derivative or subordinate features also are referred to. See, for instance, the quotation made by the District Judge from the Century Dictionary (Tr., p. 74). Parsons (1 Contracts, *144-5) says that the English statutory definition of a joint-stock company as "a partnership whereof the capital is divided or agreed to be divided into shares, and so as to be transferable without the express consent of all the co-partners" is "applicable to such companies in this country" and that "in other respects the differences between the law of joint-stock companies and that of partnerships are not very many nor very important." He makes no mention of the nature of the management. That management by a board does not negative the idea of a partnership, generically speaking, is obvious from the fact that even a joint-stock company, especially of the common law kind, is a partnership.

Moreover, even if management by a board were one of the essential and distinguishing features of a partnership of the joint-stock company kind, it alone would not be sufficient to make a partnership one of that kind, for there would also be required the feature of transferability of shares, which, as we propose to show below, is wholly absent in the present case.

Management or non-management by a board, however, is not fundamental, but is merely matter of form and convenience. Partners, as between themselves, may agree upon almost any form of management they please. Management by a board is not inconsistent with the idea of agency—assuming that there must be agency in the case of an ordinary partnership.

An agreement for management by a board may be looked upon in either of two ways. It may be regarded as merely an agreement among the parties themselves, not binding on third parties dealing with the partners (at least unless they have notice of the agreement), in which case agency would continue to exist, with the result that the partnership would be bound but that the partner who bound it by violating his agreement with the other partners would be liable to them in an action for damages for a breach of the agreement. See 1 Bates, Partnership, Sec. 315; *Morgan* v. *Child, Cole & Co.,* 47 Utah, 417, 424, 427, cited above: *Burnes* v. *Pennell,* 2 H. L. Cas. 497, 520-1.

The other way of looking upon an agreement of this kind is to regard it, not as negativing the idea of agency, but as constituting merely a delegation of their powers by the several partners to the board of managers. Accordingly, on this principle, almost any sort of arrangement may be made for the management of an ordinary partnership which the partners may desire, and it is so held by the courts. One of the most common methods is that of a managing partner. As is said in 2 Lindley, Partnership, *540-1:

> "In the absence of express agreement to the contrary, the powers of the members of an ordi-

> nary partnership are in all respects equal, even although their shares may be unequal. * * * It need, however, hardly be observed that it is perfectly competent for partners to agree that the management of the partnership affairs shall be confided to one or more of their members exclusively of the others."

For cases in which there was a managing partner, see:

McAlpine v. *Millen,* 104 Minn. 289, 298.
Aller v. *Williamowicz,* 23 Ark. 566.
Anthony v. *Wheatons,* 7 R. I. 490, 499-500.
Richard v. *Mouton,* 109 La. 465.
Ward v. *Thompson,* 22 How. 330.
Paul v. *Cullum,* 132 U. S. 539.
Fleming v. *Lay,* 109 Fed. 952.

In the first of these cases, the *McAlpine* case, the court said, at page 298:

> "The management of the business and the extent to which the business shall be conducted and be under the control of any particular partner, is also left to be arranged by the members of the partnership. The sole management may by agreement be vested in one partner."

In the last of these cases, the *Fleming* case, the owners of a number of tugs formed what they called an "association" under the name of the Sandusky Harbor Tug Line and selected a manager (it does not appear whether he was a partner or non-partner) who was to handle all the tugs, collect all the moneys,

pay all the running expenses and distribute the profits of the business among the owners of the tugs in proportion to their values, which were fixed by agreement. There was no express agreement as to losses. Some of the tugs were owned by several persons, but the aggregate owners of each were regarded as one partner. The question was, as stated by the court, "whether the association was a partnership." The court, after applying the test of co-ownership of profits and holding that the organization was a partnership, said on the question of management, at page 955:

> "It is not important that the minor stipulations in contracts of partnership vary. The subordinate incidents may differ, but, if the enterprise is aimed to secure a joint profit which is to be divided between those contributing to the business as principals, the distinguishing features of a partnership exist. If it follows from the existence of a partnership that each should have the power of agency, it may be answered in the present case that each has delegated his power in that regard to the general manager, who thereafter by consent exercised the powers of each. Indeed, such delegation of power to a common agent is not an infrequent incident to the business of partnership."

Often other arrangements are made. For instance, one of the partners might be represented by a non-partner, as in *Groth* v. *Payment,* 79 Mich. 290, 291, where a woman was represented by her brother; or the partnership might be managed entirely by a non-partner, as in *Greend* v. *Kummel,* 41 La. An. 65, where the partners were natural persons, or as in *Burke* v. *Railroad,* 61 N. H. 160, cited above, where

the management was by a general manager elected by the directors of the two corporation members of the partnership; or it might be managed somewhat as in the present case, as in *Briere* v. *Taylor,* 126 Wis. 347, 351, where a partnership was formed by three firms, which were to share the profits in proportion to their respective interests and to share the expenses in the proportion of twelve parts, fourteen parts and sixteen parts, respectively, and the partnership was to be conducted by a president representing one firm, a secretary, who was to act also as treasurer, representing another firm, and an executive committee of three, one member of which was to represent each firm; or, as precisely in the present case, as in *Mallory* v. *Hanaur Oil Works,* 86 Tenn. 598, 602, cited above, where all the partners were corporations and the management was by a board or committee made up of representatives of the several corporate members.

Ordinarily corporations act only through directors, officers or agents. Naturally, therefore, a partnership composed of corporations would be managed by representatives of the corporations and not by the corporations themselves directly as artificial intangible persons. To say that a partnership could not be an ordinary partnership, but would have to be a partnership of the joint-stock company kind, because it is managed by a board composed of representatives of the members instead of the members themselves, would amount to saying either that corporations cannot enter into or form ordinary partnerships at all, which would be contrary to all authority and practice, or else that if corporations should form partnerships they would be obliged, in order to avoid

becoming joint-stock companies, to resort to the impracticable and unreasonable course of having all of their members participate directly in the management of the partnership so formed. Indeed, even that would not obviate the difficulty, for in such case the members or stockholders of the corporations would not be the corporations but would be merely representative of them in the management of the partnership.

Not infrequently partnerships as well as corporations form partnerships among themselves or with individuals, and in such cases for somewhat similar reasons, they are apt to be represented in the partnership so formed by persons selected for the purpose, as in *Briere* v. *Taylor, supra.* But that does not make the partnership so formed a joint-stock company.

In this particular case, moreover, we desire to call special attention to the fact that under the partnership agreement and by-laws, the management is made as nearly like that of an ordinary partnership managed by all the members as is possible consistently with the fact that the members are corporations. For the members of the board of managers are not elected at large and indiscriminately by majority vote of unit shares, as is usual in the case of a joint-stock company or a corporation, but each member of the board is a special representative of one or more of the particular partners.

For instance, in the agreement (Tr., p. 39), and in Article IV of the by-laws (Tr., p. 46), it is provided that the Haiku Company shall appoint two of the managers, the Paia Company three, and the five

smaller companies one manager jointly. And by the same Article of the by-laws these managers are to "represent" the respective partners by whom they are appointed. And by Article VII of the by-laws (Tr., p. 47), a vacancy in the board is to be filled by appointment by the particular partner which "such manager represents", and similarly in the case of absence.

Under Article III of the by-laws (Tr., p. 45), general meetings of the partnership are to be made up of the entire boards of directors of all of the partners, each partner being thus represented as fully and individually as a corporation can be. And in Article VI of the by-laws (Tr., p. 47), a quorum at such a meeting is to consist of "a majority of the partners, both in numbers and interest," and each corporate member is to have the sole decision as to whether it is properly represented by its board of directors at such meeting.

In Article XVI (Tr., p. 53), the by-laws go even so far as to give the stockholders of each of the corporate members, although they are not partners themselves, the same rights of inspection and examination of the books and records of the partnership and the same rights of investigation into the partnership affairs, that they have in the several corporate members in which they hold stock.

If management by one general manager or by a board of managers representing the members puts a partnership in the joint-stock company class, then all the definitions of joint-stock companies must be revised. Also, if that is the case, then any partnership, even if formed by only two or three individuals and

with their *delectus personarum* most carefully preserved by express covenant against transferability, would nevertheless, if so managed, be a joint-stock company! The argument for a joint-stock company and against an ordinary partnership based on the feature of management by a board, as well as that based on the fact that the partners are corportions, leads too far and defeats itself.

3. *There is an entire absence of the essential features of a joint-stock company, namely, the existence of unit shares and the changeability of membership through mere transfers of such shares; and on the other hand there is present the contrasting characteristic feature of an ordinary partnership, a delectus personarum.*

This is the question of chief importance in the case, for it goes to the real difference between a joint-stock company and an ordinary partnership; and naturally the decision of the District Court turned upon this. That court, as we understand, took the position (Tr., pp. 75-76) that the Company in question has a capital stock divided into unit shares; that these shares are transferable because there is nothing in the partnership agreement or in the law to prohibit their transfer; that any such transfer would carry with it to the transferee the right to participate in the management of the Company and make the transferee a full member of the Company without requiring the consent of the other members; that even if a transfer would not have that effect it would, nevertheless, not operate to dissolve the Company, because the partnership agreement provides that nothing shall work a

dissolution except the mutual consent of the parties to it, and hence that this is a joint-stock company. We submit that not one of these positions is supported either by the partnership agreement or by law.

These propositions have to do with the doctrine of *delectus personarum,* which, of course, simply means choice of persons, or that the contract is between particular persons or corporations and cannot be changed so as to be between others in whole or in part except by the consent of all. In other words, one party to the contract cannot, by a transfer of his interest or otherwise, change the contract. He might break it, but that is a different thing. Besides numerous authorities referred to *passim* in this brief, see Anderson, Law Dict., Tit., *Delectus;* Story, Partnership, Secs. 5, 195; 22 Am. & Eng. Encyc. of Law, 2nd Ed., 15.

The District Judge seems to have assumed that as matter of law a change in the membership of a partnership may be effected by the action of one member without the consent of the others through a transfer of his interest unless there is something in the partnership agreement to prevent. The rule, we submit, is precisely the reverse. This follows from the very nature and definition and characteristics of a partnership. Indeed, it is just here that the difference lies between an ordinary partnership and a joint-stock company. The latter is an ordinary partnership plus the additional feature of transferability or changeability of membership. The non-changeability of membership in an ordinary partnership without the consent of all is an incident of such a partnership, and is not the result of an express agreement to that

effect. The position of the District Judge goes too far, for, if it were correct, all partnerships would be joint-stock companies, unless there were some provision in the partnership agreement against changeability.

True, it is sometimes said that the consent of all to a change may be given in advance as well as at the time or subsequently. That, of course, is so in the case of joint-stock companies, the agreements for which provide for transfers and changes of shares and membership, but it is this very feature that makes it a joint-stock company as distinguished from an ordinary partnership. Sometimes also it is said that consent may be given beforehand to a change even in the case of an ordinary partnership without making it a joint-stock company. That also is true, as where it is specially provided that on the death of a partner his representative may take his place in the partnership, or where special provision is made for the transfer of a partner's interest in certain contingencies, but not only are such cases different from the ordinary cases of changes in membership through the transfer of unit shares, as in the cases of corporations and joint-stock companies, but, strictly speaking, even in such cases it is not the same partnership that continues but a dissolution of the old partnership and the creation of a new partnership. The mere statement, or necessity for the statement, that there may be an express agreement beforehand as well as at the time or afterwards for a change in the membership of an ordinary partnership shows that in the absence of an agreement for a change there cannot be such a change. Mining partnerships are *sui generis*

and require no consent to changes. They are often referred to as differing in this respect from ordinary partnerships. I Bates, Partnership, Secs. 162, 163.

No doubt, also, one partner, without the consent of the others, may transfer his property interest, but that would not result in the introduction of the transferee as a partner in place of the transferor. The transfer would result in a dissolution of the partnership, and the transferee would not even be a tenant in common of the property with the other partners, but would have merely the right to call for a settlement of the partnership affairs and to receive his share of the net proceeds after the payment of debts, and the other partners would retain the exclusive right of control over the property for the purpose of winding up the partnership affairs.

Bank v. *Carrollton Railroad,* 11 Wall. 624, 628.
Home State Bank v. *Vandolah,* 188 Ill. App. 123, 128.
Monroe v. *Hamilton,* 60 Ala. 226, 231.
Miller v. *Brighem,* 50 Cal. 615.
Reece v. *Hoyt,* 5 Ind. 169.

Equally unfounded is the other proposition of the District Judge, that even if a transfer would not have the effect of admitting the transferee as a partner without the consent of the other partners, such a transfer would, nevertheless, not dissolve the company because of the provision in the partnership agreement (Tr., p. 76) that

"The term of the existence of the said co-part-

nership hereby formed, shall be forty-five (45) years, beginning with the 1st day of January, A. D. 1904, unless sooner terminated by the mutual consent of the parties hereto."

Even if this provision would prevent a dissolution notwithstanding the transfer of the interest of one of the partners, still, if such a transfer would not admit the transferee as a partner, the transferor would still be a partner and there would be no change in membership, and the company would still be an ordinary partnership and not a joint-stock company, for the very gist of a joint-stock company is the changeability of membership through the transferability of shares, and not merely the transferability of property interests alone apart from a change of membership. For instance, a partner may mortgage his interest in the partnership without causing a dissolution of the partnership or ceasing to be a partner or making the mortgagee a partner, and, of course, without making the partnership a joint-stock company.

Of course, also, if the transferee in case of an absolute transfer did not remain a partner, as of course would be the case, so that neither the transferor nor the transferee was a partner after the transfer, either a dissolution of the partnership would thereby be effected or else there would continue to be merely an ordinary partnership of the remaining partners. There would not be a joint-stock company. Of course, also, no such results could have been contemplated.

This argument also of the District Judge, based on the fact of a fixed term for the continuance of the partnership, goes too far; for, if it were correct, no

partnership having a fixed term could be an ordinary partnership, and every partnership having such a term would be a joint-stock company, and yet it is common for ordinary partnerships to have fixed terms. See I Bates, Partnership, Sec. 222; 1 Parsons, Contracts, *157. There were fixed terms in the cases of *Mallory* v. *Hanaur Oil Works,* 86 Tenn. 598 (1 and 2 years), *Burke* v. *Railroad,* 61 N. H. 160 (5 years), *News-Register Co.* v. *Rockingham Pub. Co.,* 86 S. E. (Va.) 874 (10 years), and *Bank* v. *Carrollton Railroad,* 11 Wall. 624 (25 years), cited above. In *Meaher* v. *Cox, Brainard & Co.,* 37 Ala. 201, 215, the term was ten years.

What, then, is the significance of the provision in question? In the first place, the latter portion of it, to the effect that the partnership shall continue for the designated period "unless sooner terminated by the mutual consent of the parties hereto" is strongly confirmatory of the idea of a *delectus personarum* and so has the opposite effect from that attributed to it by the lower court. It shows that the contemplated consent in this respect is intended to be the consent not only of all the parties but of the particular seven corporations named as parties to the instrument. If there could be changes in membership through transfers or assignments of their interests by some of the partners, still under this provision the partnership could be terminated within the designated period, not by the mutual consent of the members for the time being, but only by the mutual consent of the original seven parties to the agreement, which, of course, could not have been contemplated and would be absurd. Of course a partnership may be terminated before the

expiration of its specified term by mutual consent without any express stipulation that that may be done, but the fact that a stipulation was inserted that this may be done only by the original parties to the instrument shows that changes in membership through transfers by the several parties, as in the case of a corporation or a joint-stock company, were not contemplated.

As to the first part of the provision—prescribing a fixed term for the partnership—the effect of this, *if any,* upon the question of changeability of membership, would be, not that there might be changes without resulting in dissolution, but that there could not be changes inasmuch as they would result in dissolution.

Just what is the effect of a provision for a fixed term, is a matter of some difference of opinion. As we have seen, it is not that what would otherwise be an ordinary partnership is thereby made a joint-stock company, or that it by implication permits changes in membership without the consent of all the partners. The main object of such a provision is doubtless to provide against a dissolution at mere will, but it does not even have that effect. Its effect is merely that, while any partner may, notwithstanding such provision, effect a dissolution through a transfer of his interest, or at his mere will without such a transfer, that would be a breach of the contract and subject him to liability in an action for damages for the breach unless he had good cause for so doing. Thus such a provision acts as a practical deterrent to a dissolution without good cause and provides a means for compensating the other part-

ners for damages in case of an unjustifiable dissolution. A court of equity also would place some weight on such a provision in deciding whether to decree a dissolution for alleged cause or whether to restrain a dissolution for a reasonable time in order to prevent irreparable damage.

The English rule seems to go to the extent of holding that under such a provision a partner will not be permitted to effect a dissolution at will, and that has the support of Judge Story (Partnership, Sec. 275), but the rule of the Roman Law permitted a dissolution to be effected by one of the partners, notwithstanding such a provision, and this has the support of Chancellor Kent (3 Com. *55). The latter, we submit, has now become the established American rule.

Bates, Partnership, Secs. 243, 577, 578.
22 Am. & Eng. Encyc. of Law, 2nd Ed., 205.
30 Cyc. 651.

These text books, while showing that the decided weight of authority favors dissolubility nothwithstanding such a provision, shows also that in a number of jurisdictions in the United States there has been more or less of a leaning the other way. They refer to cases in Alabama, Arkansas, Connecticut, Iowa, Mississippi, North Carolina, New Jersey, New York, Ohio, Pennsylvania, Utah, West Virginia and one United States Circuit Court. But an examination of these cases shows that in the Iowa case the court, although it intimated doubt as to the law, expressed its own view that the rule permitting dissolution was

the more reasonable; that in the Alabama, Connecticut, Mississippi, North Carolina and Ohio cases, the question was not decided, but merely a query was raised or the rule against dissolution was assumed merely for the purposes of the case and held not to apply or was referred to in some other way; that, as shown by the citations below, the later cases in Connecticut, New York, Ohio and Pennsylvania support the rule favoring dissolution, and that the Utah case was reversed on this point on appeal to the Supreme Court of the United States, the decision of which, also, of course, superseded the decision of the United States Circuit Court above referred to, thus leaving practically only Arkansas, New Jersey and West Virginia supporting the English rule.

In support of the Roman and American rule see:

Karrick v. *Hannaman,* 168 U. S. 328.
Maysenburg v. *Littlefield,* 135 Fed. 184, 187.
Lapenta v. *Lettieri,* 72 Conn. 377, 383.
Solomon v. Kirkwood, 55 Mich. 256, 259, 260.
Mason v. *Connell,* 1 Whart. 381, 387.
Sclemmer's Appeal, 58 Pa. St. 168, 176.
Skinner v. *Dayton,* 19 Johns, 513, 537.
Cockner v. *Bruckner,* 54 Oh. St. 214.
Cape Sable Company's Case, 3 Bland (Md. Ch.) 606, 674.
Blake v. *Dorgan,* 1 Greene (Ia.) 537, 540.

Even under the English rule supported by Story it is recognized that, notwithstanding a provision for a fixed term, a partnership is dissolved *ipso facto* by any one of a number of occurances, such as the death or bankruptcy or (in the case of a woman) the marriage of a partner. Story, Partnership, Sec. 302 *et seq.*

For the same reasons, the disincorporation or forfeiture of the franchise of any of the corporate members of the partnership in question would cause a dissolution. It is also recognized under the English rule that, nothwithstanding such a provision, equity may dissolve the partnership for cause. *Id.,* Secs. 275, 282. Furthermore, a distinction is made even under that rule between a dissolution at the mere will of one of the partners and as a result of a transfer or assignment of his interest, which would make it practically impossible or difficult or undesirable to continue the partnership. Accordingly, it is held even under the English rule, that, notwithstanding a fixed term, a dissolution will result from an assignment or transfer of the interest of a partner, thus permitting him to do indirectly what he could not do directly under that rule. *Id.,* Secs. 307, 308; 1 Lindley, Partnership, *230-231.

Thus it is clear that no express provision against changeability of membership is required, as nonchangeability is an inherent incident of partnership; and no claim is made for the Government that there is any provision for changeability in this case. It is equally clear that the provision for a fixed term does not carry an implication of changeability. We propose now to show that there is no such implication from the nature of the so-called capital stock of the Company and the shares of its members, and finally that, so far from there being any express or implied sanction of changeability, the partnership agreement contains much that affirmatively shows that no changeability was contemplated.

The Company in question has no nominal or fixed

capital stock as distinguished from capital or capital assets and no unit or equal or nominal or transferable shares. There is nothing comparable to the usual nominal capital stock of a corporation or joint-stock company divided into nominal transferable shares of specified par value, whether paid up or not. Not that the existence of a specified capital stock would prevent this Company from being an ordinary partnership, for such a partnership may and often does have such a capital stock, but this Company does not even have that. It has merely capital, consisting of the user of all of the properties of its several specifically named members, irrespective of their values, which are not specified or even estimated, and of such other properties as it may acquire from time to time by reinvestment of earnings or borrowings or otherwise. Of greater importance, there are no transferable unit shares. There is absolutely nothing to indicate that the Company was formed simply as an impersonal enterprise for profit, irrespective of the make-up of its membership, and with the idea that its membership might fluctuate indefinitely through the sale and purchase and transfer of shares.

It is true that the partnership agreement (Tr., p. 31), speaks of "the capital stock" of the Company and also says that it shall be divided into "Thirty-five (35) equal shares or interests", but it is obvious that, construing the agreement and by-laws as a whole, "capital stock" is here used merely in the sense of "capital" or "capital assets" and that "shares *or interests*" was used merely by way of furnishing a method of expressing the entire proportional indivisible interests of the respective seven particular named

members of the partnership. The same paragraph of the agreement proceeds to state that twelve of these thirty-five shares or interests shall belong to the Haiku, eighteen to the Paia, and one each to each of the other five named members The paragraph, taken as a whole, is merely a method of stating that the Haiku Company shall have a twelve-thirty-fifths, the Paia an eighteen-thirty-fifths, and each of the other named members a one-thirty-fifth share or interest in the partnership. This is shown, if need be, even more clearly by Article II of the by-laws (Tr., p. 45), which refers to "the respective interests of the partners as set forth in the Articles of Partnership", showing both that the parties concerned had in mind only the proportional entire interests of the partners and that this is the interpretation which they themselves put on the agreement, and which also says that these "respective interests of the partners" shall be evidenced by "*a* certificate" showing that only one certificate was to be issued for the entire interest of each partner. Similarly, Article IV of the by-laws (Tr., p. 46) provides that the managers shall "represent the partners in accordance with their respective interests." As matter of fact no such contemplated certificate for each partner's entire interest has ever been issued, and of course there never was any intention of issuing unit-share certificates. (Tr., p. 13.)

The specifications of the proportional shares or interests of the respective partners in the partnership was evidently made for the purpose of determining the proportions in which the profits and losses are to be shared as specified in the agreement (Tr., pp. 40-41), and the proportions in which the surplus funds,

if any, are to be shared on a dissolution of the partnership as also specified. (Tr., p. 43). See also Subdiv. 7 of Article IX of the by-laws. (Tr., p. 50.) This is just what would be expected in any partnership in which there are unequal interests. See 2 Lindley, Partnership, *610, 611; 30 Cyc. 440. Several of the cases already cited illustrate this. For instance, in *Mallory* v. *Hanaur Oil Works,* 86 Tenn. 598, the shares or interests were in certain proportions agreed upon, where only the use of the properties was contributed by the several corporate members of the partnership, as in the present case. In *Briere* v. *Taylor,* 126 Wis. 347, where the partners where firms instead of corporations, the proportions were twelve parts, fourteen parts and sixteen parts, respectively. In *Paul* v. *Cullum,* 132 U. S. 539, the proportions were eight-tenths and two-tenths, respectively. In *Meaher* v. *Cox, Brainard & Co.,* 37 Ala. 201, where two firms formed a partnership, one to contribute the use of ten steamboats, and the other of two steamboats, each to retain the ownership of its vessels, the proportions were four-fifths and one-fifth, respectively.

The difference between the so-called capital stock of a partnership and of a corporation or a joint-stock company is set forth to some extent in 2 Lindley, Partnership, *610-613, 660-661, 675-678. In the case of a partnership the share of a partner is merely his proportional interest, while in the case of a corporation or joint-stock company, there is a specified nominal capital stock divided into unit shares which are transferable and which may or may not be paid up.

"Capital stock" may be used in several senses. It may mean nominal capital or actual capital or various

other things. Here it means actual capital in the sense of capital assets. "Capital" and "capital stock" are often used interchangeably or synonymously in this ~~case,~~ sense, although, strictly speaking, when used with reference to corporations they should be distinguished to some extent. For instance, in *State* v. *Cheraw & Chester R. Co.,* 16 S. C. 524, the court said, at page 528:

> "Capital stock and capital are synonymous terms, hence capital stock. In this general sense it is money invested in business operations, whether that business be conducted by a single individual, a partnership, a corporation, or a government; and it makes no difference how the money is obtained, whether by labor, by borrowing or otherwise."

The court then proceeded to point out that when used in connection with corporations capital stock has a more limited sense. See also.

Foster v. *Stevens,* 63 Vt. 175, 182.
Kohl v. *Lilienthal,* 81 Cal. 378, 385.
Goodnow v. *American Writing Paper Co.,* 73 N. J. Eq. 692, 695.

A case in which the Federal Supreme Court used "capital stock" and "capital" interchangeably in the case of a corporation is *Scottish Union & Nat. Ins. Co.* v. *Bowland,* 196 U. S. 611, 627. A case in which the same court used these terms interchangeably in the case of a partnership is *Paul* v. *Cullum,* 132 U. S. 539, 548-550.

That "capital stock" is used in the sense of capital

in the present case is shown further by the paragraphs following the paragraph in question and specifying the contributions of the several partners to the so-called capital stock. (Tr., p. 32.) For instance, the first of these paragraphs is entitled "Kalialinui contribution to *capital.*" The paragraph itself states that the Kalialinui Company "shall contribute as its share toward the capital stock of the said company, the use during the term of the said partnership of all of its" property, etc. Kalialinui's share is what it contributes. It is the use of all of its property irrespective of its value. There is no subscription or payment for shares. The use of property is contributed, not in payment for capital stock, but toward or as a part of the capital stock. Capital stock in this instance means merely stock of capital. The fact that only the use of the property is contributed instead of the property itself and that each partner continues in the ownership of its property makes this additionally clear.

So much as to the nature of the "capital stock" and the "shares or interests" therein. Now as to transferability. If there is any one thing that is clear in this case, it is, we submit, that the respective shares or interests of the several partners are not transferable so as to enable transferees to become members of the partnership. Not only is there an entire absence of any provision for transfers, as there always is, so far as we have observed, in the articles of association of a joint-stock company, but the agreement and the by-laws are full of evidences that the partnership contract in this case was intended to be exclusively between these particular corporations and no others. Not only that, but it is shown in the complaint (Tr.,

p. 14) that the partnership was formed "in view and by reason of identity in large part of the shareholders of the several or individual corporate partners or members and the close and special relations between and among them", and also, after setting forth that each partner contributed only the use of its property, that the partnership was formed "in view and by reason of natural and special relations of the said several properties to each other", and the agreement itself, in its first recital (Tr., p. 29), sets forth that *"the parties hereto* are the owners respectively of certain lands and water rights and personal property hereinafter more particularly described, * * *which said rights and property, owing to the location and situation thereof can more profitably and advantageously be operated in common than by each party hereto separately."* Thus, the agreement is between these particular corporations alone for special personal and property reasons and for the use in common of their respective particular properties, the ownership of which is to be retained by them.

The agreement is between these corporations by name and each named corporation is the "Party of the First Part" or "Party of the Second Part", etc., (Tr., p. 28). The partners are referred to time and again as "the said partners", meaning these corporations. They are not referred to as the members or shareholders or stockholders of the Company. There is no definition to the effect that words descriptive of these corporations shall include their assigns. There is no provision specifying that transfers may be made or how transfers may be evidenced. As already stated, it is stipulated that the partnership may be dissolved

within its specified term only by the "mutual consent of *the parties hereto*". (Tr., p. 31.) As also already stated, a twelve-thirty-fifths interest "shall belong to Haiku", an eighteen-thirty-fifths to Paia, etc. (Tr.. p. 31.) The profits and losses are to be borne in the proportion of twelve-thirty-fifths *by Haiku,* etc., (Tr., p. 40). Likewise, the surplus, if any, on dissolution is to go twelve-thirty-fifths *to the said Haiku,* etc., (Tr., p. 43). Under the agreement (Tr., p. 39) and Articles III, IV, VI and VII of the by-laws (Tr., pp. 45, 47) the managers are to be appointed by these particular corporate members by name, and vacancies and absences are to be filled by the particular partner or partners represented by the manager who is absent or whose office is vacant, and each of these partners is to be represented at general meetings of the partnership by its board of directors and is to determine whether it is properly represented by its board of directors. If the share or interest of any partner were transferable and should be transferred, the transferor, under the agreement and by-laws, would still have the authority to appoint its representative or representatives on the board of managers and otherwise to take part in the management of the partnership, while the transferee, if entitled to anything, would be entitled to only its proportion of the profits and losses, but it is difficult to see how it could be entitled even to those, for the provisions on that subject are that the profits and losses "shall be borne *by the parties hereto*" and also "in the proportion of twelve-thirty-fifths (12/35) *by the said Haiku Sugar Company,* eighteen-thirty-fifths (18/35) *by the said Paia Plantation* and one-thirty-fifth (1/35) *by each*

of the said Parties of the Third, Fourth, Fifth, Sixth and Seventh Parts." (Tr., p. 40.)

Throughout also it is manifest that only corporations were contemplated as partners, and yet, if the shares or interests of these corporate partners were transferable, they could be transferred to individuals as well as to corporations, and there is no provision in the agreement or by-laws for the appointment of any managers by individuals, not to mention other difficulties that would arise. Furthermore, as already shown and as alleged in the complaint (Tr., p. 13), the interests of the respective partners are not divisible. For instance, the Haiku Company with twelve-thirty-fifths could not split its interest and transfer, say, one thirty-fifth. If it could do that, there would be further difficulties, as, for instance, suppose it transferred one thirty-fifth to one person, five thirty-fifths to another and seven thirty-fifths to a third, how would the two members of the board of managers to be appointed by the Haiku Sugar Company thereafter be appointed; and under Article III of the by-laws, how could any such transferee, particularly if an individual, be represented at a general meeting of the partnership; and under Article VI of the by-laws, since a majority of the partners in both number and interest constitute a quorum, if the Paia Company should sell its eighteen-thirty-fifths to eighteen different persons, the transferees of that partner alone would be a majority in both number and interest and thus could absolutely control the partnership, contrary to the intention of this provision. Article VIII of the by-laws, moreover, provides that notice of meetings shall be served upon each director of each of the

respective partners, etc. Article XX provides for amendments of the by-laws in certain respects only "by a nine-tenths vote of all of the stockholders of each and every partner corporation."

If there ever was an agreement that was intended to subsist between the parties to it alone and not to contemplate that any single party might itself, and against the consent of the others, substitute another or others in its place, this, we submit, is such an agreement.

IV.

THE STATUTE SHOULD BE CONSTRUED LIBERALLY IN FAVOR OF THE TAX PAYER.

In the District Court opposing counsel cited *De-Ganay* v. *Lederer,* 239 Fed. 568, 571, 572, (decided by a District Judge), in support of the views that in the construction of a statute considerable weight should be given to the position taken by the executive and that ~~the~~ tax statutes should be liberally construed in favor of the Government.

The District Judge in that case cited no authorities for these views and also stated in effect that these views did not help much, since the question after all was that of the construction of the statute, which of course was for the court.

On the question as to what weight should be given to the view taken by the executive, we submit that that depends upon how doubtful or evenly balanced is the question of the meaning of the statute, upon

how long and to what extent the construction given by the executive has been acted upon and acquiesced in, and to what extent hardships might or might not result from a change in the construction. See *Houghton* v. *Payne,* 194 U. S. 88, 99; *Studebaker* v. *Perry,* 184 U. S. 258, 268; *United States* v. *Tanner,* 147 U. S. 661, 663; *McNally* v. *Field,* 119 Fed. 445, 448. If the courts were to be bound by the views of one of the parties to the controversy—the executive—of what use would it be for the other party to go to the courts? Fortunately, under our system of government, the construction of statutes is left to the judicial branch. Numerous cases might be cited in which the courts have overruled the Bureau under the Federal income and corporation tax laws. In *Eliot* v. *Freeman,* 220 U. S. 178, the Federal Supreme Court overruled the Bureau on the question as to what companies were covered by the law of 1909, which is the question involved in this case under the law of 1913. And see *Edwards* v. *Keith,* 231 Fed. 110, 113 (petition for certiorari denied, 243 U. S. 638). In the present case, however, if the rule advocated by the other side has any application, it is favorable to the Company, for the Bureau took the position now taken by the Company from 1909 to 1915 (see p. 6 above), and changed its view only in 1916 and then, as we contend, only because of an erroneous impression as to the facts.

On the question of liberal construction, it is the established view of the Federal courts that tax laws should be construed liberally in favor of the tax payer and especially as to exceptions named in such statutes. *Eidman* v. *Martinez,* 184 U. S. 578, 583; *State of*

Ohio v. *Harris,* 229 Fed. 892, 898; *Rockefeller* v. *O'Brien,* 224 Fed. 541, 546; *Mutual Ben. L. Ins. Co.* v. *Herold,* 198 Fed. 199, 201. Here partnerships are expressly excepted. The specific controls the general in such laws. *American Net & Twine Co.* v. *Worthington,* 141 U. S. 468, 474. Courts also lean strongly against constructions which would result practically in double taxation. *Tennessee* v. *Whitworth,* 117 U. S. 129, 137. This has special application to the present case.

V.

MISCELLANEOUS.

1. *Interest.* Interest should be allowed from the date of the payment of the taxes under protest, September 8, 1916. See

Erskine v. *Van Arsdale,* 15 Wall. 75.
Shell v. *Cochran,* 107 U. S. 625.
National Home v. *Parrish,* 229 U. S. 494.
Billings v. *United States,* 232 U. S. 261.
Kinney v. *Conant,* 166 Fed. 720.
Herold v. *Shanley,* 146 Fed. 20.

2. *Costs.* Similarly, costs are allowed in cases of this kind against collectors of internal revenue. For example, see

Industrial Trust Co. v. *Walsh,* 222 Fed. 437.
Baldwin Locomotive Works v. *M'Coach,* 215 Fed. 967.

On both interest and costs see also Black, Income Taxes, Sec. 384.

3. *Proper party defendant.* Although a suit may be brought against the United States for the recovery of taxes illegally collected (*Emery, Bird, Thayer R. Co.* v. *United States,* 198 Fed. 242, 249; *Christio Street Co.* v. *United States,* 136 Fed. 326), it may also, and usually is, brought against the collector. Treasury Decision 2394. But the suit in cases of this kind is against the collector personally, although the Government is to pay the judgment, and hence not only can it not be brought against his successor, but, upon his death after suit brought, his executor or administrator and not his successor should be substituted in his place. *Patton* v. *Brady,* 184 U. S. 608; *Roberts* v. *Lowe,* 236 Fed. 604; *Philadelphia H. & P. R. Co.* v. *Lederer,* 239 Fed. 184, affirmed 242 Fed. 492.

In this case the suit was brought against the collector to whom the taxes were paid (Tr., p. 2), but he died on August 10, 1917, and the executor of his will was substituted for him.

In conclusion, we respectfully submit that the judgment of the District Court should be reversed and the case remanded to that court with instructions to enter judgment for the plaintiffs for the amount claimed, with interest and costs.

Dated at Honolulu, T. H., January 29th, 1918.

Respectfully submitted,

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